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INTRODUCTION

In accordance with the City Auditor's 1990-91 Audit Workplan, we have reviewed the City's Investment Program. We conducted this audit in accordance with generally accepted government auditing standards and limited our work to those areas specified in the Scope and Methodology section of this report.

BACKGROUND

Section 806 of the City of San Jose's (City) Charter established the Finance Department. One of the powers and duties of the Director of Finance is to *"...deposit and invest funds in accordance with principles of sound treasury management and in accordance with the applicable laws or ordinances..."*

In May 1984, the City experienced a significant investment bond loss. After this event, the Administration took several major steps to improve the management and operation of the City and the Redevelopment Agency (RDA) investment programs. The Department of Finance prepared a new Investment Policy and established procedures to carry out the Policy requirements. In addition, Finance changed the format and content of the monthly investment reports to more effectively convey results of investment activities. Also, Finance and the RDA prepared cash flow forecast reports to assist in day-to-day investment decisions. Further, the Administration's Internal Investment Committee was revived.

In August of 1985, the Finance Committee requested that the Office of the City Auditor perform reviews of the investments for the City and RDA portfolios. Since the fall of 1985, the City Auditor has issued eight reports assessing the Finance Department's compliance with the Investment Policy. These reports contained a total of thirty-one recommendations designed to enhance compliance with the Policy provisions and improve the investment program. To date, all of the recommendations are implemented.

In APPENDIX D, the Finance Department informs us of its major accomplishments in the administration of the investment program. It should be noted that our audit scope did not include a comprehensive review of all the areas covered in Finance Department's memorandum. According to the Acting Director of the Finance Department, noteworthy investment program accomplishments include:

1. Developing a list of acceptable issuers of commercial paper, bankers acceptances, and negotiable certificates of deposit;
2. Obtaining signed service agreements with the dealers and financial institutions through which the City completes its investment transactions; and
3. Developing an in-house cash flow program that the Finance Department uses in scheduling maturities to meet the City's operating cash requirements.

SCOPE AND METHODOLOGY

We reviewed the adequacy of documented procedures and the execution of such procedures over the investment process. In addition, we reviewed the City and the Redevelopment Agency investment transactions for the month of January 1991 to determine compliance with the Investment Policy.

To evaluate the adequacy of the procedures over the investment process and the execution of such procedures, we reviewed written procedures, interviewed Treasury personnel, and examined the sample transactions discussed below to see if applicable procedures were, in fact, followed. To evaluate compliance, we sampled transactions in January 1991 and tested each sample item for proper instrument type, rating, maturity, diversification limits, and where applicable, adequacy of collateralization. In addition, our review covered other compliance requirements such as: safekeeping, dealer pre-qualifications, timeliness of written confirmations, wire fund transfer controls, and exception reporting. Furthermore, we reviewed files and records to determine whether confirmation documents were matched with the bank/dealer advices on a timely basis. Finally, we reviewed various Treasury-generated investment reports to determine if they contained the information necessary to facilitate the investment process.

FINDING I

**FOR THE INVESTMENT TRANSACTIONS TESTED,
THE FINANCE DEPARTMENT/TREASURY DIVISION
WAS OPERATING IN COMPLIANCE
WITH THE CITY'S INVESTMENT POLICY.
HOWEVER, TREASURY NEEDS TO IMPROVE THE DOCUMENTATION
OF ITS INVESTMENT PROCEDURES AND THEIR EXECUTION,
AND THE CITY'S ADMINISTRATION NEEDS
TO ADDRESS A SEPARATION OF RESPONSIBILITIES PROBLEM**

The Treasury Division (Treasury) of the Finance Department is responsible for all City of San Jose (City) investment activities. As such, Treasury, among other things, is to invest the City's and Redevelopment Agency's (RDA) temporarily idle funds in accordance with the City's Investment Policy, applicable State of California Government Code, San Jose Municipal Code, and San Jose City Charter requirements. Our audit of Treasury's investment activities during January 1991 revealed no non-compliances with the City's Investment Policy. However, our audit also revealed that Treasury needs to improve the documentation of several of its investment procedures and the execution of those procedures. In addition, our audit revealed that: 1) the Chief of Accounting is the Acting Director of Finance, 2) the Assistant Director of Finance position is eliminated, and 3) the Chief of Treasury position is vacant, as it has been for all but six months since February 1988. As such, the Chief of Accounting is, by definition, in a position to perform functions that are organizationally incompatible. Accordingly, Treasury should fully document its investment procedures and their execution, and the City Administration should fill the Chief of Treasury position. By so doing, Treasury will have added assurance that, over time, it will not violate the City's Investment Policy, and the Finance Department will have an acceptable separation of investment and accounting responsibilities.

Treasury Division

The Treasury Division of the Finance Department is responsible for all investment activities. Included in the Finance Department's mission statement in the operating budget for the fiscal year June 30, 1990, is the following sentence: "The Department also oversees the investment of surplus and idle funds..." Included in Treasury's program purpose and description is the following statement: "Temporarily idle funds of the City and the Redevelopment Agency are invested in accordance with the City's Investment Policy and associated procedures until those monies are required for disbursement."

Located within Treasury is the Investment Section. The goals and objectives of the Investment Section in priority order are safety, liquidity, and rate of return. Accordingly, the Investment Section attempts to earn a reasonable rate of return on invested funds, but not at the expense of safety or liquidity.

No Investment Policy Non-compliances Noted

At the end of January 1991, the City and RDA pooled investment portfolio totaled \$609,484,642.32. During the month, Treasury purchased \$165,526,167.13 in various securities. We reviewed a sample of investments held and purchased in January, along with various investment reports, to determine if they were in compliance with the City's Investment Policy. Our tests revealed no non-compliances. It should be noted that we could not test all of the City's Investment Policy provisions for compliance. For example, we could not test the City's reverse repurchase policy for compliance because the City did not enter into any reverse repurchase agreements during our audit test period. This also applies to Investment Policy provisions for negotiable certificates of deposit, time deposits, and medium-term corporate notes. APPENDIX C summarizes the City's

Investment Policy criteria and the fact that no instances of non-compliance were found.

Treasury Needs To Improve The Documentation Of Its Investment Procedures And The Execution Of Such Procedures

Treasury is responsible for placing investments in accordance with the City Council-approved Investment Policy. This Policy largely sets parameters for investing the City's money. Treasury is responsible for establishing procedures and controls to ensure compliance with the City Council-approved Investment Policy.

Treasury has developed an informal packet titled "Investment Procedures". The following is a list of sections the packet contains:

- Purpose/Goal
- Organization/Reporting
- Basic Elements
- Controls

While this packet has valuable information on the investment process, it does not include a complete list of procedures, nor does it describe how the execution of those procedures is to be documented. The book Investing Public Funds states the following with regards to documenting procedures:

"Documentation of procedures is a vital element of the internal control system....For internal control purposes, documentation should include a description of organizational structure, identification of functions and employee responsibilities, a step-by-step description of the investment transaction and related funds transfer processes, and a complete description of forms and procedures used to execute and confirm investment transactions."

APPENDIX B lists the procedures Treasury has in place for the investment process. APPENDIX C summarizes the results of our review as to whether these procedures and their execution are documented.

Audit Procedures And Results

We reviewed for compliance the City Council-approved Investment Policy provisions regarding:

- Purchases
- Portfolio Mix
- Pre-qualification of Dealers
- U.S. Government Agency Issues
- Repurchase Agreements
- Commercial Paper
- Bankers Acceptances
- Negotiable Certificates Of Deposit
- Time Deposits (Over \$100,000)
- Reverse Repurchase Agreements
- Medium-Term Corporate Notes
- Safekeeping-Treasury Procedures
- Safekeeping-Security/Collateral Held
- Reporting

We found that: 1) Treasury has 41 procedures in place to ensure compliance with the above Investment Policy provisions, 2) those procedures appear to be adequate to ensure compliance with the City Council-approved Investment Policy, and 3) Finance Department personnel followed these procedures, when applicable, for the transactions we tested.

However, we found one or more of the following deficiencies in Treasury's documentation of its procedures or in the documentation of the execution of the applicable procedure.

Observed Documentation Deficiency

- Procedure is not documented, and documentation of procedure execution is absent.
- Procedure is not documented.
- Documentation of procedure execution is absent.
- Procedure is partially documented, and documentation of procedure execution is absent.
- Procedure is only partially documented.

Treasury can correct the above deficiencies by fully documenting its 41 investment procedures and requiring its staff to sign off or initial various documents when they have executed applicable investment procedures.

**Chief Of Accounting Is Performing Functions
That Are Organizationally Incompatible**

Currently, the Chief of Accounting is the Acting Director of Finance. The Assistant Director of Finance position is eliminated, and the Chief of Treasury position is vacant, as it has been for all but six months since February 1988. As such, the Chief of Accounting is, by definition, in a position to perform functions that are organizationally incompatible. Specifically, the Chief of Accounting, acting as the Director of Finance, is also organizationally over the Treasury function. The book Investing Public Funds states the following:

“To control the investment function, most public entities rely on a combination of organization designs, systems and procedures. These can be summarized as follows:

Organizational design - separation of functions . . .

At a minimum, most governments seek to separate the investment transaction (buying, selling and wire transfer) functions from the accounting and reporting functions.”

From the foregoing, it is clear that a separation of incompatible functions is considered necessary in order to eliminate any potential discrepancies or violations with regards to the Investment Policy. It should be noted that the vacant Chief of Treasury position is subject to the Administration’s hiring freeze. That hiring freeze notwithstanding, in our opinion, the City Administration should fill the vacant Chief of Treasury position as soon as possible in order to have an acceptable separation of investment and accounting responsibilities.

CONCLUSION

Our audit of Treasury's investment activities during January 1991 revealed no non-compliances with the City's Investment Policy. However, our audit also revealed that Treasury needs to improve the documentation of several of its investment procedures and the execution of those procedures. In addition, our audit revealed that the Chief of Accounting is currently the Acting Director of Finance and, by definition, is in a position to perform functions that are organizationally incompatible given the vacant and/or eliminated positions within the Finance Department/Treasury Division.

RECOMMENDATIONS

We recommend that the Finance Department/Treasury Division and City Administration:

Recommendation #1:

Fully document the City's investment procedures and the execution of such procedures. (Priority 3)

Recommendation #2:

Fill the Chief of Treasury position. (Priority 2)

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